



PUBLIC EMPLOYEE RETIREMENT SYSTEM OF IDAHO
607 North 8th Street
BOISE, IDAHO 83702

MINUTES
OF
MEETING OF RETIREMENT BOARD

The Board of the Public Employee Retirement System of Idaho met at the PERSI Administration Building, 607 North Eighth Street in Boise, Idaho at 8:28 a.m. July 27, 2004. The following members were present:

Jody B. Olson
J. Kirk Sullivan
Pamela I. Ahrens
Dennis Johnson
Clifford T. Hayes

Executive Director Alan H. Winkle, Deputy Attorney General Brian Kane, Chief Investment Officer Robert Maynard, Financial Officer James Monroe and Management Assistant Joanne C. Ax were also in attendance. The electronic projection of materials and documents discussed in the meeting was handled by Betsy Griffith. Other persons attending portions of the meeting were:

Rod MacKinnon
William Palumbo
Drew Black
Brian McGrath
Casey Maslonka
Dennis Fitzpatrick
Mike Boren
Doug Bates
Chris Growney
Jim Coleman
Jim Shakelford
Matt Freeman
Karen Steffen
Robert Schmidt
Pete Kerrick

Mountain Pacific Investment Advisors
Mountain Pacific Investment Advisors
DB Fitzpatrick & Co.
DB Fitzpatrick & Co.
DB Fitzpatrick & Co.
DB Fitzpatrick & Co.
Clearwater Advisors
Clearwater Advisors
Clearwater Advisors
PERC – Retired Teachers
IEA
LBO
Milliman, Inc.
Milliman, Inc.
Milliman, Inc.

Richelle Sugiyama
Diane Berg
Rhonda Yadon

PERSI
PERSI
PERSI

EXECUTIVE SESSION

Citing Idaho Code Section 67-2345(b) which allows the Board to discuss personnel issues privately, the Board went into Executive Session at 8:30. They reconvened in regular session at 8:35 a.m.

WELCOME OF NEW TRUSTEE

Chairman Olson welcomed Clifford T. Hayes who has been appointed by the Governor to succeed Susan Simmons as Trustee to the Board. Mr. Hayes is Chief of Police for the City of Post Falls, a PERSI Employer Member.

PERSONNEL MATTERS

Chairman Olson said that during the Executive Session the trustees had completed the performance evaluation of Executive Director Alan Winkle. Trustee Sullivan said that considering the amount of work accomplished, the quality of that work and the leadership demonstrated by Mr. Winkle over the past months, he recommended a 6% merit increase for Mr. Winkle. That motion was seconded by Trustee Johnson and unanimously approved by the Board.

MINUTES

Approval of the Minutes: By motion duly made by Trustee Sullivan and seconded by Trustee Johnson, the Board unanimously approved the minutes of the May 25, 2004 regular meeting of the Retirement Board. The June Board retreat minutes and the July 13, 2004 Private Equity Meeting minutes were also approved in that motion.

PORTFOLIO

Monthly Portfolio Update: Mr. Maynard had distributed his investment report dated July 25, 2004, which was an update from a version previously provided to the Board. That report noted that the fund is down 2.7% for the month.

Mr. Maynard spent time reviewing the complete Fiscal Year 2004 Investment Report. PERSI had a very good, and in many ways spectacular, fiscal and calendar year. The 2004 fiscal-year return of 18.1% was on par with the boom-year returns of 1995-2000. The 2003 calendar-year return of 25.6% was the best calendar-year return in PERSI's history (since 1966). PERSI's peer performance rankings rebounded strongly as well, ranking as high as in the top 5% of public funds in the nation for some periods and well above median for almost all time periods.

Our Private Equity representatives from Hamilton Lane will attend the August meeting and will have information on the buyout of Boise Cascade. Madison Dearborne is a well respected company with a good reputation for making profitable acquisitions.

Responding to a question from the Chair, Mr. Maynard said he does not intend to reduce the amount we have invested in TIPS, but in the fall

when we conduct a fixed income manager search, we may have them actively managed as there are other real-return bonds available internationally that could meet the requirements. Holding those inflation-protected bonds allows us to invest more heavily in equities and maintain a lower level of risk on the total portfolio.

Mr. Maynard's monthly report will now have a section showing the impact of Board policies and active management on the total fund returns. The Board will be able to review this section to quickly determine which policies are helping or hindering in a given market. Our strategies in TIPS, Emerging Markets, REITS, Global Equities and rebalancing currently drive positive returns in our portfolio. Going forward, Mr. Maynard does not expect all of these to work positively at the same time, but does not plan to change our basic strategies. He plans to work more actively on the other Board strategies in the coming months.

Responding to a question from Trustee Johnson regarding the Idaho Mortgage Program return, Mr. Maynard clarified the account is reported in terms of market value and provided a brief explanation on how that portfolio is valued.

Chairman Olson thanked Trustee Sullivan for chairing the private equity manager interviews. \$20 million was committed to Kohlberg Investors V, \$25 million to a follow up investment in Providence V, and not more than \$20 million will be invested in the Hamilton Lane Secondary Fund LP.

Manager Comments: The Chairman invited managers who were present to comment on the markets and the economy. Doug Bates of Clearwater Advisors believes that interest rates will not rise as quickly as others have thought. While he believes fundamentals are in place for those rates to rise moderately, he expects the markets to be choppy with sideways movement. Brian McGrath expects uncertainty to the end of the year through the elections and is predicting inflation at year end to be about 4-5%. He feels it is a dangerous time for bonds in the next 6-12 months. Dennis Fitzpatrick expects the next-five-year equity returns to be between 7-9% and bonds to return 4-5%. Rod MacKinnon believes the market correction is due to the price of stocks getting ahead of earnings. Earnings now look healthy so he is expecting positive returns for Mountain Pacific Investment Advisors.

Recent reports have indicated that the US and Idaho are losing higher paying jobs forcing workers to accept work for which they are over-qualified. Trustee Ahrens asked what short-term impact we might expect as Boise Cascade employees make job changes with the newly-announced buyout. Mr. McGrath said the reports may be just rhetoric about the low quality of the jobs. National surveys are reporting a new high in employment. He noted that the "service jobs" category in these reports includes professional desk jobs. He optimistically believes that as we come out of the recession there will be more small business opportunities. Mr. Fitzpatrick said corporate overhead is down and companies are using overseas outsourcing. Mr. Maynard added that the share of earnings dedicated to salaries is very

low. However, they may be at the end of the cycle where all the profit can go to the bottom line – some will now have to go towards salaries.

EXECUTIVE DIRECTOR

CEM Report Discussion: Mr. Winkle reviewed the memorandum dated July 19 which had previously been provided to the Board. He noted that it takes nearly a year before the final report is available. It provides some of the additional information the Board has requested on how PERSI compares to peer systems in its operations. Chairman Olson asked how we could calculate how many individuals are directly affected by the PERSI benefit. Actuary Karen Steffen suggested the Idaho Census as a source for family size.

Administration costs continue to be lower than that of peers per active member and annuitant. Responding to a question from Trustee Sullivan, Mr. Winkle said our collection data maintenance is high relative to that of our peers because others are highly automated in the data area. We continue to need physical review of microfiche. As our system becomes more automated, we will more closely mirror our peer systems. PERSI also has many very small employers who must transmit data to PERSI. Each of these "reporting points" must be reconciled. Other systems also have more complex systems with several benefit and contribution "tiers" which complicates their data. Trustee Ahrens asked how much such a report costs us. Financial Officer Jim Monroe said \$25,000 annually. Mr. Winkle said this includes attendance of up to three staff members at an annual conference where the report and other areas are reviewed. It also includes access to the data of all the other systems and a peer network for questions as they arise. Mr. Winkle said focus is placed each year on a different area such as communications or websites for a detailed comparison review.

Strategic Plan: Each year state agencies are required to file a Strategic Plan. Mr. Winkle reviewed his July 19, 2004 memorandum summarizing the plan. Trustee Johnson asked how one could measure accomplishments of this plan when it will be replaced each year going forward with a new plan. Mr. Winkle said projects and targets remain on new plans with completion or progress noted. Rather than there being an entirely new plan each year, the progress on current plans and changes or additions are shown. By motion duly made by Trustee Johnson and seconded by Trustee Sullivan, the Board unanimously approved the Strategic Plan for FY 2005 -2008 dated 7/15/2004 as submitted.

Status Update: Mr. Winkle reviewed his May 18, 2004, memorandum to the Board which provided a summary of the projects in which PERSI is involved. The Process Review Project is progressing on time. Mr. Winkle continues to work with the colleges and universities on the ORP/PERSI classification issue. The FRF Average Wage Calculation change programming is complete. Chairman Olson asked how the firefighters feel about this change. Mr. Winkle said he has met with their representatives and they support the change. The Bonner County transfer of Funds to the PERSI

401(k) plan worked smoothly. Those participants now have access to their investments 24/7.

The market timing issue is being addressed with trading restrictions effective August 1. Participants will be limited to two international transfers (trades) per fund within a 90-day period. Security on the PERSI Website has been upgraded to require use of a password. The maintenance of the password system is automated and can deliver new and lost passwords without human intervention.

Two new charter schools became PERSI employers effective July 1, 2004. Victory Charter School in Nampa and Thomas Jefferson Charter School in Emmett received their charters and hired employees. Charter schools are mandated into PERSI by Idaho law, so no Board action is required. Trustee Ahrens asked how PERSI membership is handled if a Charter School loses its charter. Mr. Winkle said this would be handled as a withdrawal. Employees would become inactive unless they moved to another Idaho school or PERSI employer.

Staff continues to work on ideas for needed legislation which they will bring before the Board. We perform annual financial audits of the plan, but this has never been a required function. At a future meeting the Board may decide whether to propose adding this in Idaho Code. We also are drafting legislation to clarify police-officer-status criteria for a jailer and to clarify that benefit changes apply to members active at the time of the change.

Experience Study – Adoption of Assumptions: Actuaries Karen Steffen and Robert Schmidt of Milliman had previously furnished a detailed report to the Trustees. Ms. Steffen began her discussion by noting that another name change of the firm has been made. The name has been changed to Milliman, Inc. to reflect the global character of the company.

Setting actuarial assumptions is important because if costs are overstated, justified benefit improvements may be denied and current taxpayers bear a burden that belongs to future taxpayers. If costs are understated, inappropriate benefit improvements may be enacted or future taxpayers may bear the burden that belongs to current taxpayers.

Ms. Steffen reviewed the current actuarial methods, the effect changes in one assumption have on other assumptions and reviewed actual experience of the PERSI base plan. Because PERSI does not use a smoothing technique to determine actuarial liability, there are immediate consequences to a drop or rise in investments. Using smoothing, such changes may be spread over about 5 years.

Chairman Olson said the Gain Sharing legislation on which Trustee Sullivan worked has served PERSI well, so gains can be shared with members and employers on a one-time basis and not obligate the fund to long-term enhancements.

Trustee Johnson asked why the actuary would recommend lowering the investment return assumption when we have just completed a stellar year earning 18.1%? Ms Steffen said the actuarial calculation looks out 35 or more years into the future when benefits will actually be paid to many of the members. While we appreciate the current good returns, the

assumptions look forward and the investment return assumption change is required to maintain a 4% real return assumption.

The recommended assumptions are based on the fact that contribution rates will continue their gradual rise back to the 1997 level as is in current law. Trustee Ahrens said with the great investment returns, it is more and more difficult to justify the contribution rate increase. She asked whether it will be necessary to implement the second and third parts of those increases. Ms. Steffen said that decision can be addressed in December when more economic information is available. Mortality tables are changing showing that Americans are living longer so plans must have more money with which to pay benefits longer. Our amortization period could increase as this information changes. After discussion, by motion duly made by Trustee Johnson and seconded by Trustee Hayes, the Board unanimously approved the change in actuarial assumptions as recommended by Milliman, Inc.

FISCAL:

Audit Letter of Engagement: In the past, the Board has delegated oversight of the annual PERSI audit to an Audit Committee headed by a Trustee. Former Trustee Susan Simmons performed this task during her tenure. During this transition year, Chairman Olson recommended that the entire Board sit as the committee. The auditor will come before the entire Board with issues formerly handled by Ms. Simmons. Financial Officer James Monroe said Ms. Simmons was a great help and in the future he would like to have a formal committee. Chairman Olson agreed reiterating that this is a transition year. By motion duly made by Trustee Sullivan and seconded by Trustee Johnson, the Board unanimously approved the signing of the audit engagement letter as submitted.

Administrative, Portfolio and Out-of-State Travel Reports: Mr. Monroe reviewed the reports that had previously been furnished to the Board. At the close of the fiscal-year 2004, we had saved approximately \$500,000 of the annual operating appropriation. The savings were across several categories and departments for various reasons such as a postponed printing job, as well as postage and consulting services that were not used. The increasing use of electronic communications, when appropriate, added to the savings. Reviewing the Out-Of-State Travel report, Chairman Olson said he is encouraging Trustees to participate in at least one conference each year and an international conference every-other year. As fiduciaries of a fund reaching nearly \$8 billion with 20% invested internationally, attendance at these conferences keeps Trustees informed as to what peer systems are doing. Trustee Ahrens said her recent participation has been highly educational and beneficial. She recommended that the report heading state that this is an Out-of-State Travel and Training Report since educational costs are included. Mr. Monroe will make that addition to future reports.

Because the Business Process Review is in progress, our FY2006 budget request is being delayed a month to allow inclusion of the BPR report results. In reviewing the administrative budget report, Mr. Monroe explained that disability assessment costs on this report included four months' worth of

billings. This was due to an annual rebalancing of costs to actual experience during the year. The normal monthly payments to the vendor were delayed while that assessment was completed. In the portfolio budget report, investment fees were lower in the portfolio area as managers were terminated and others were hired, so some periods had fewer active managers.

DC PLAN

Year-end 401(k) Report – DC Plan Manager Diane Berg provided statistics on the Choice Plan including assets, participation, loans and withdrawals. During the past year, plan assets have increased 34% and the average account balance has increased 36%. The number of members who are regularly contributing to their 401(k) increased by 22%. Members continue to use their accounts for loans and hardship withdrawals, repaying their loans to preserve their retirement nest eggs. International trading restrictions are expected to be in place for August 1, as previously approved by the Board, to address market timing issues. The merger of the Bonner County Money Purchase Plan with the Choice Plan is complete. Ms. Berg is monitoring pending legislation regarding guardsmen and reservists for impact on the plan. We are also designing a new employee brochure and planning Choice Plan presentations to encourage employee participation in this voluntary plan.

Trustee Sullivan asked about the possibility of accepting additional post-tax types of rollovers and contributions into the Choice Plan. Ms. Berg said she is continuing to research the issue.

LEGAL

Smythe Hearing Officer Appointment: Mr. Winkle reviewed a memorandum dated July 15 from Deputy Attorney General Brad Goodsell which recommended that the Board authorize the Executive Director to appoint a hearing officer to conduct a contested case hearing and to issue a recommended decision in this appeal. By motion duly made by Trustee Sullivan and seconded by Trustee Johnson, the Board unanimously approved that recommendation.

Final Decision – Daniel Appeal: During discussion of the issue which had been presented in documents provided earlier to the Board, Chairman Olson asked Trustee Hayes if it would be unusual for a janitor to be called a fireman. Trustee Hayes said that it would. By motion duly made by Trustee Johnson and seconded by Trustee Hayes, the Board unanimously affirmed the Director's Decision, denying the appeal of Mr. Daniel.

FUTURE MEETINGS:

Tuesday, August 24, 2004, 8:30 a.m., Boise - PERSI office

Thursday, September 23, 2004, 8:30 a.m., Boise - PERSI office

Tuesday, October 26, 2004, 8:30 a.m., Boise - PERSI office

Tuesday, November 30, 2004, 8:30 a.m. Boise - PERSI office

Tuesday, December 14, 2004, 8:30 a.m., Boise, PERSI office

Adjournment: There being no further business before the Board, by motion duly made by Trustee Sullivan, seconded by Trustee Hayes and unanimously approved by members present, the meeting concluded at 11:30 a.m.

Jody B. Olson
Chairman

Alan H. Winkle
Executive Director